COMMENTARY

The Crisis Commission's Missing Witness

To really get to the roots of the financial debacle, call Alan Greenspan and give him the third degree

By Paul M. Barrett

The public debut of the Financial Crisis Inquiry Commission on Jan. 13 featured Wall Street bosses striking alternately defensive and humble poses while pundits recalled the glory days of New Deal investigator Ferdinand Pecora. The contrition seemed mostly shallow, especially compared with the bankers' obvious impatience over the occasional sharp question. More important, it seems likely that the hopeful historical references to Pecora will ultimately prove disappointing.

One way the commission could salvage something meaningful from the hearing room theater would be to bear down on a former Washington player so far not on the witness list. That would be Alan Greenspan.

In the run-up to the commission's opening act, many commentators invoked Pecora, the peppery chief counsel who 77 years ago galvanized a Senate investigation of the 1929 crash. The Pecora Commission, as it came to be called, revealed abuses that showed Depression-era Americans just how much Wall Street was a semi-rigged casino. We will likely get some of the same as the Financial Crisis Inquiry Commission (and let's hope someone devises a catchier name soon) holds hearings in coming months.

The Pecora Commission also laid the groundwork for legislation establishing the Securities & Exchange Commission and insulating the staid depository and lending functions of commercial banking from the riskier trade in securities. That framework kept commercial banking relatively safe, if dull, for a half-century. Its bipartisan demolition, beginning in the 1980s, together with the purposeful demoralization of institutions such as the SEC, helped recreate a free-for-all, 1920s-style environment in the 2000s. You know what happened next.


January 1933: Banker Donald Durant is sworn in before a Senate panel

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Do not expect the bipartisan FCIC, chaired by Phil Angelides, a former California state treasurer, to rival the impact of Pecora. We will not see the likes of the Securities Act of 1933, the Glass-Steagall Act of 1933, and the Securities Exchange Act of 1934. This time around, Wall Street lobbyists got the jump on the legislative process. The major battles on Capitol Hill have already been fought, with only the details left to resolve.

After all of President Barack Obama's fulminating over the largely symbolic issue of investment banker bonuses, Wall Street is writing checks with just as many zeroes, and Congress isn't going to do anything about it. Obama and lawmakers bought the financial wizards' insistence that substantial curbs on derivatives speculation would somehow threaten the Republic. What we'll probably get instead is greater transparency for some, but not all, derivatives trading. This half-measure will allow new petri dishes of systemic risk to fester in darkness as Wall Street returns to the "financial innovation" laboratory. Congress is expected to make it easier for the government to step in once a financial conglomerate starts to fail. But the idea of revisiting

January 2010: Blankfein, Dimon, Mack, and Moynihan take the oath

KEVIN LAMARQUE/REUTERS

Glass-Steagall's separation of commercial banking from securities speculation never got past the daydreams of Paul Volcker, Obama's marginalized emissary from a distant and more commonsensical era of regulatory caution. The big three credit-rating agencies will continue to enjoy a government-blessed oligopoly while collecting fees from the very institutions whose securities they evaluate.

That's not to say that the commission will fail to examine some episodes of fraud, greed, and hubris. "We may well find criminal activity as well as egregious practices that were not only permitted but exalted," Angelides said on Jan. 13. The Wall Street CEOs conceded that things got out of hand, implying that all the really horrific stuff happened in some other guy's shop. "Too many financial institutions and investors simply outsourced their risk management," Lloyd C. Blankfein, chairman and CEO of Goldman Sachs, said in his opening statement.

Hearing room talk is one thing; real change, another. Ask the cigarette manufacturers. Representative Henry Waxman (D-Calif.) publicly sautéed their CEOs in 1994. A lot of lawsuits followed. But tobacco remains a very lucrative, very deadly business.

The best way for the commission to make a name for itself is not to focus solely on banker avarice and mortgage fraud—much of which has already come to light in the past year—but to conduct a symposium on the fundamental causes of our financial troubles. The two major ones: 1) the persistently low interest rates in the early 2000s that inflated the bubbles in housing and credit and 2) the notion that financial markets police themselves.

As the Fed's domineering chief from 1987 to 2006, Alan Greenspan enforced a hands-off orthodoxy based on the idea that government officials can't distinguish between markets overheating dangerously and prices rising because of economic fundamentals. Rather than prick bubbles too early, the Fed should do damage control after a crash, he told the Senate Banking Committee in July 1999: "Mitigate the fallout when it occurs, and, hopefully, ease the transition to the next expansion."

DON'T EXPECT 1930s-STYLE REFORM. THIS TIME, WALL STREET LOBBYISTS GOT THE JUMP ON THE LEGISLATIVE PROCESS

Following this strategy, Greenspan did little to address the Internet craze of the 1990s, which ended in a stock bust and recession. He and his colleagues mitigated the fallout by hacking interest rates and flooding the economy with cheap money. That seemed smart at the time; the recession of 2001 was relatively brief. But by keeping rates artificially low for several years, the Fed replaced the Internet stock bubble with a real estate bubble, as John Cassidy, economics correspondent for *The New Yorker*, observes in his instructive book *How Markets Fail* (2009). Faced with the ensuing consumer borrowing binge and soaring

home prices, Greenspan and his colleagues did nothing.

They also blithely ignored the manic leveraged gambling on Wall Street predicated on a fantasy of ever-rising real estate values. Investment banks could be trusted to keep one another honest, Greenspan said.

That turned out to be incorrect. Greenspan's legacy is having combined reckless easy money policies with even more reckless antiregulatory zeal, Richard A. Posner, the economist and federal judge argues in his forthcoming volume, *The Crisis of Capitalist Democracy*. Posner adds: "The regulators of money and banking—of monetary policy and financial intermediation—were asleep at the switch."

So I suggest that the crisis hearings quickly move to giving Greenspan the third degree. In his characteristically convoluted way, the ex-Fed chairman already conceded to Congress, in October 2008, that he had been naive about self-regulation. Let's get him to say it in plain English—and more than once. Hearing a discredited Greenspan concede grave error could possibly free Washington of his lingering influence; maybe it would even embolden a few more lawmakers to show some resolve in the face of Wall Street's formidable lobbying machine.

The commission could sit Greenspan's successor, Ben Bernanke, next to him at the witness table. Bernanke, who has agreed to testify, acknowledged in early January that regulatory failings contributed to the crisis. But since he was at Greenspan's right hand as a member of the Fed board for most of the crucial 2002-06 period, Bernanke's passive-voice implication that it was someone else's regulatory screw-ups that led to woe seems, well, inadequate. Even more disturbing, Bernanke continues to insist implausibly that low interest rates didn't feed the bubblefest.

A reincarnated Ferdinand Pecora would want to skewer a few dishonest mortgage peddlers and unmask reckless credit-default-swap jockeys. Some of that wouldn't hurt. But if the Financial Crisis Inquiry Commission wants to make its own name, the panel needs to expand its witness list by at least one. |BW|

EMPTY CLAWBACKS?

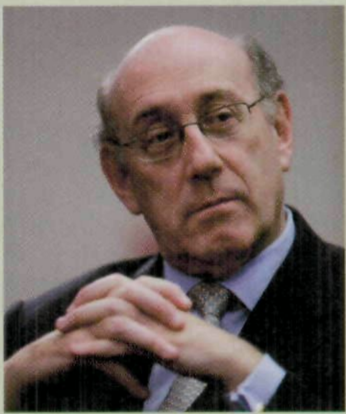
The tool for recouping bonuses remains untested

By Alexis Leondis and Margaret Collins

Many executives will find something extra in their 2009 bonuses: conditions on whether they can keep the money.

Of the 100 largest U.S. companies by revenue, 70 say they have so-called clawback provisions that allow them to recoup pay. That's up from 16 in 2006, according to Equilar, a compensation research firm. "The concept of a clawback is gaining credibility and frequency," says Kenneth Feinberg, the Treasury Dept.'s special master on executive compensation. "Whether it will be effective in promoting stability and growth remains to be seen."

Companies were under pressure to do something given the public outcry over supersized pay, especially at big banks. Some 75% of 1,000 Americans surveyed by Bloomberg in December said bailout recipients shouldn't give out bonuses. The Federal Deposit Insurance Corp. is looking at clawbacks, and Senate lawmakers want to make them mandatory at companies that issue inaccurate financial reports.



U.S. pay czar Feinberg doesn't know if clawbacks will deter risky behavior

RICHARD CLEMENT/NEWSCOM

Rather than waiting for legislation, Goldman Sachs, Morgan Stanley, Motorola, Pfizer, Safeway, and others are putting clawback clauses into employment contracts. Some companies can rescind bonuses for excessive risk-taking. Others can recoup pay for unethical behavior. Executives may have to forfeit cash or stock up to four years after the payout. "There's no such thing as free money," said Liam O'Brien, managing partner at New York law firm McCormick & O'Brien.

Companies that have had clawbacks haven't used them much. That's because the process can be long and costly, particularly when an employee has spent the money or quit. Employers usually have to go to court or arbitration to enforce the rules. More companies, though, may be taking action. Last year there was a 57% jump in breach-of-contract arbitration cases, which sometimes involve clawbacks, according to the self-governing Financial Industry Regulatory Authority.

Recently regulators have been going after bonuses more aggressively. In July the Securities & Exchange Commission sued Maynard Jenkins, former CEO of car parts retailer CSK Auto, demanding that he forfeit $4.1 million he received from 2003 to 2005 when company employees allegedly inflated earnings. (Under the Sarbanes-Oxley Act, the agency can seize payments to top executives of companies that have inflated earnings or engaged in other misconduct.) It's the first time the SEC has gone after an executive who it hasn't accused of wrongdoing.

Jenkins asked a court to dismiss the case. His attorney, John Spiegel of Munger, Tolles & Olson, said in a statement this summer that the SEC is "overreaching." Said Rosalind Tyson, director of the SEC's Los Angeles office, in a July statement: "Jenkins was captain of the ship and profited during the time that CSK was misleading investors. The law requires Jenkins to return those proceeds."